DEPARTMENT OF STATE REVENUE

02-20221088.ODR

FINAL ORDER DENYING REFUND: 02-20221088
Corporate Income Tax
For the Years 2017 and 2018

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

The Department did not agree that Communication Services Provider was justified in including Holding Company in its Indiana consolidated income tax returns; the Department found that Holding Company was not conducting business within Indiana.

ISSUE

I. Indiana Corporate Income Tax - Members of an Indiana Consolidated Corporate Tax Return.

Authority: IC § 6-3-1-11; IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-3-4-14; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Hunt Corp v. Indiana Dep't of State Revenue*, 709 N.E.2d 766 (Ind. Tax Ct. 1999); 45 IAC 3.1-1-38; *Spectrum Licenses*, https://itlaw.fandom.com/wiki/Spectrum_license.

Taxpayer argues that it is entitled to a refund of corporate income tax because the Department erred when it found that one of its affiliates should not have been included in its amended consolidated tax returns.

STATEMENT OF FACTS

Taxpayer is a company in the business of providing communications services. Taxpayer routinely files for and pays Indiana corporate tax.

Taxpayer filed amended corporate tax returns for the years 2017 and 2018. Taxpayer filed the returns to include one of its affiliates herein designated as "Holdings." As Taxpayer explained, "Holdings" was inadvertently omitted from those original returns and that the amended returns were submitted in order to correct that omission. If accepted, the amended returns would have resulted in tax refunds of approximately $680,000.

The Indiana Department of Revenue ("Department") reviewed and then rejected the returns. The Department rejected the returns on the ground that Holdings should not have been included in the two returns. As a result, the Department denied the refunds.

Taxpayer disagreed with the decision and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representatives explained the legal and substantive basis for the protest. This Final Order Denying Refund results.

For clarity's sake, the Department herein takes note of Taxpayer's references to "combined returns" the Department's audit refers to "consolidated" returns, and the returns themselves are labeled as "combined/consolidated" returns.

I. Indiana Corporate Income Tax - Members of an Indiana Consolidated Corporate Tax Return.

DISCUSSION

The issue is whether Taxpayer has met its burden of establishing that "Holdings" should have been included in Taxpayer's amended Indiana consolidated returns on the ground that "Holdings" is conducting business within Indiana by virtue of its continuing ownership interest in the spectrum licenses.

Taxpayer has an associated company herein designated as "Holdings." Holdings is a limited liability company

located outside Indiana. Holdings loaned substantial amounts of money to the disregarded Partnerships. The proceeds of that loan to Partnerships were used by Partnerships to purchase "spectrum licenses." The loans are "secured" by the cash proceeds of the loan and an interest in the spectrum licenses.

> A spectrum license is permission given by a government agency (such as the U.S. Federal Communications Commission) to an entity that gives that entity exclusive rights to use a frequency band for a particular application, such as radio broadcasting. Licenses are designated for a specific geographic area, such as rural areas, metropolitan areas, regions, or the entire nation. *Spectrum Licenses*, https://itlaw.fandom.com/wiki/Spectrum_license (Last visited November 29, 2022).

For purposes of this Final Order Denying Refund, the Department presumes that spectrum licenses are a limited and valuable commodity and that the Partnerships leased or sold licensees the right to utilize a particular frequency band in a particular geographic area.

Taxpayer cites to IC § 6-3-2-2(a)(5) as authority for its position that Holdings was correctly included in the amended returns. The authority relied upon states that:

> With regard to corporations and nonresident persons, adjusted gross income derived from sources within Indiana, for the purposes of this article, shall mean and include:
> (1) income from real or tangible personal property located in this state;
> (2) income from *doing business in this state*;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property to the extent that the income is apportioned to Indiana under this section or if the income is allocated to Indiana or considered to be derived from sources within Indiana under this section. (*Emphasis added*).

In addition, Taxpayer relies on 45 IAC 3.1-1-38(5). The regulation provides in part:

> Doing Business. For apportionment purposes, a taxpayer is "*doing business*" in a state if it operates a business enterprise or activity in such state including, but not limited to:
> (1) Maintenance of an office or other place of business in the state
> (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
> (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
> (4) Rendering services to customers in the state
> (5) Ownership, rental or operation of a business or of property (real or personal) in the state[.]

Taxpayer explains its rationale in part as follows:

> Pursuant to 45 IAC 3.1-1-38(5) ownership or rental of property within the state is indicative of "doing business" in Indiana. As a result of [Taxpayer] having intangible assets (intangible property) within the state, [Taxpayer] had a 2017 and 2018 filing obligation with Indiana.
> Pursuant to IC § 6-3-2-2(a)(5), only affiliated group members with adjusted gross income derived from sources within the state of Indiana can be included in an Indiana combined filing. As a result of [Taxpayer] having Indiana sourced intangible income, [Taxpayer] is includable in [Taxpayer's] amended 2017 and 2018 Indiana filings.

Based on Taxpayer's explanation, the Department understands that Holdings lent money to various Partnerships; the Partnerships used the money to purchase spectrum licenses; the Partnerships earn money by selling or leasing the licenses; the Partnerships repay the loan to "Holdings."

In challenging the Department's decision, Taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). The statutes and authorities relied upon in this decision "are presumptively constitutional." *Indiana Dep't of State Rev. v. Caterpillar, Inc.*, 15 N.E.3d 579, 587 (Ind. 2014). When an agency such as the Department is charged with enforcing a statute, the jurisprudence defers to the Department's reasonable interpretation of that statute "over an

equally reasonable interpretation by another party." *Caterpillar, Inc.*, 15 N.E.3d at 583.

Indiana imposes a tax on the adjusted gross income of every corporation that has adjusted gross income derived from sources within Indiana. IC § 6-3-2-1(b); IC § 6-3-2-2.

To compute the income subject to Indiana corporate income tax, Indiana adopts a multistep process to calculate a corporation's taxable Indiana adjusted gross income. *Caterpillar, Inc.*, 15 N.E.3d at 581. Indiana generally follows the tax principles established in the federal law. IC § 6-3-1-11. Indiana statutes refer to the Internal Revenue Code in order to compute accurately and consistently what constitutes each taxpayer's Indiana income tax.

IC § 6-3-1-3.5(b) provides the mathematical starting point in determining a corporation's taxable income, stating that the term "adjusted gross income" shall mean, "In the case of corporations the same as 'taxable income' (as defined in Section 63 of the Internal Revenue Code) adjusted as follows . . . ." In determining the taxpayer's Indiana adjusted gross income, Indiana first refers to I.R.C. § 63 as the beginning point. In other words, when used "[i]n the case of corporations," the term "'adjusted gross income' shall mean the same as 'taxable income' (as defined in Section 63 of the Internal Revenue Code)" with certain modifications. IC § 6-3-1-3.5(b).

As to Indiana *consolidated returns*, Indiana law stipulates which entities may be included in a consolidated return and which may not. IC § 6-3-4-14(a) provides:

> An affiliated group of corporations *shall have the privilege of making a consolidated return* with respect to the taxes imposed by IC 6-3. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all of the provisions of this section including all provisions of the consolidated return regulations prescribed pursuant to Section 1502 of the Internal Revenue Code and incorporated in this section by reference and all regulations promulgated by the department implementing this section prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

IC § 6-3-4-14(b) defines what is an "affiliated group" as follows:

> For the purposes of this section the term affiliated group shall mean an affiliated group as defined in Section 1504 of the Internal Revenue Code with the exception that the affiliated group *shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana*. To be included in a consolidated return, the law requires that the entity must have "adjusted gross income" derived from *activities within the state*. (*Emphasis added*).

IC § 6-3-2-2(a) in relevant part, further provides that:

> With regard to corporations and nonresident persons, adjusted gross income derived from sources within Indiana, for the purposes of this article, shall mean and include:
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property to the extent that the income is apportioned to Indiana under this section or if the income is allocated to Indiana or considered to be derived from sources within Indiana under this section.

Therefore, for Holdings to have "adjusted gross income from sources within Indiana," it must have taxable income including either Indiana apportionment factors resulting in deemed Indiana business income (or losses) or nonbusiness income (or losses) that is allocated to Indiana and which is attributable to doing business within the state. IC § 6-3-2-2; *Hunt Corp v. Indiana Dep't of State Revenue*, 709 N.E.2d 766, 781 (Ind. Tax Ct. 1999).

The Department here finds it appropriate to allow Taxpayer the opportunity to speak for itself.

> In [Holding's] case, the underlying assets, here spectrum licenses, were acquired and secured by the loan [Holding's] provided to the Partnerships. Applying the same methodology as [in Letter of Findings

> 02-2002031 (April 2005)] the interest income should follow the situs of the underlying assets. As a result, the interest income received from spectrum licenses having situs in Indiana should be treated as Indiana source income and included in the sales factor numerator.
>
> Indiana law states that intangible income is sourced to the location of the income producing activity. In this instance, the interest income is a result of the intangible assets having situs within Indiana which produced Indiana sourced interest income. Income producing activity includes the sale, licensing or use of intangible personal property within Indiana. As a result, [Holding's] received Indiana sourced income from interest income produced as a result of the licensing of intangible assets within Indiana.

The Department is unable to discern a clear path between the money paid by the spectrum licensees and Holdings. The Department is unable to discern the "activities" undertaken by Holdings that would substantiate Holdings' taxable nexus with this state.

Assuming that Indiana spectrum licensees pay money to utilize the licenses located within Indiana, that money is paid to Partnerships. Although the Partnerships' ability to repay the loan to Holdings is, of course, dependent on payment of license fees (some which may be derived from Indiana), Holdings' income consists of loan repayments. Although there is an indirect financial relationship between Holdings, the spectrum licenses, the license fees, the loan arrangement, and Holdings' income, the Department is unable to tie the licenses income to Holdings' Indiana activities or the conduct of business within the state. Holdings has no Indiana employees, members of Holdings' staff do not visit the state, do not provide assistance to Indiana licensees, do not provide technical assistance to the licensees, and does not conduct any of the day-to-day activities which one would normally expect from a company "doing business" in this state.

Although not directly relevant, the Department here notes that although incorporated in 2013, there is no indication that Holdings concluded in the past that its activities in the state required it to file an Indiana income tax return.

In arriving at this conclusion, the Department believes that the Tax Court's analysis in *Hunt* is instructive in addressing the questions raised here by Taxpayer. In that case, the court found that three members of an affiliated group of companies lacked adjusted gross income derived from conducting business in the state and could not be included in the group's consolidated return. *Hunt Corp.*, 709 N.E.2d at 780-82. The three members had no sales, payroll, or property within the state even though they received interest income from commercial paper issued by an Indiana bank. *Id.*

"Holdings" is a special purpose entity formed to provide financing to its Partnerships, thereby permitting the Partnerships to purchase spectrum licenses from the federal government and thereafter for Partnerships to sell or lease those licenses to locations across the country, including Indiana. While Holdings has an ownership interest in the Partnerships and the Partnerships make loan payments to Holdings, this is unrelated to the issue of the Partnerships making loan payments to Holdings. The Department is unable to agree that Taxpayer has clearly established that "Holdings" is conducting business activities within the state.

Taxpayer asks the Department to find that its analysis, explanation, and circumstances clearly and inevitably lead to the conclusion that Taxpayer's position is correct; the Department is unable to agree that the issue is as clear cut as Taxpayer makes it out to be and cannot sustain Taxpayer.

FINDING

Taxpayer's protest is respectfully denied.

February 7, 2023

Posted: 04/19/2023 by Legislative Services Agency
An html version of this document.